DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 99-0145
FINANCIAL INSTITUTIONS TAX
For the 1992, 1993, 1994, 1995, and 1996 Tax Years

NOTICE: Under 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position regarding a specific issue.

ISSUES

I. Whether I.R.C. § 265 Expenses Should Be Deducted From the Denominator of the Apportionment Factor.

Authority: IC 6-5.5-2-4; I.R.C. § 265.

The taxpayer argues that, for purposes of calculating the apportionment denominator, its income should not have been adjusted downward for I.R.C. § 265 expenses.

II. Whether I.R.C. § 291 Expenses Should Be Deducted From the Denominator of the Apportionment Factor.

Authority: IC 6-5.5-2-4; I.R.C. § 291.

The taxpayer argues that, for purposes of calculating the apportionment denominator, its income should not have been adjusted downward for I.R.C. § 291 expenses.

III. Whether Foreign Exchange Income Should Be Deducted From the Denominator of the Apportionment Factor for Purposes of Determining the Financial Institutions Tax.

Authority: IC 6-5.5-1-10; I.R.C. § 61.

The taxpayer argues that, for purposes of calculating the apportionment denominator, its income should not have been adjusted downward based upon the receipt of foreign exchange income.

IV. Whether Taxpayer, As a Bank Holding Company and Its Various Subsidiaries, Constitute a Unitary Group.

Authority: IC 6-5.5-1-18; 45 IAC 17-3-5(d).

The taxpayer argues that the taxpayer and its various constituent subsidiaries are separate and do not constitute a unitary entity for the purpose of calculating the state's Financial Institutions Tax.

V. Constitutionality of the Application of the Apportionment Method for Unitary Groups Filing a Combined Return.

Authority: IC 6-5.5-2-4.

The taxpayer challenges the method of apportioning to Indiana the income of resident taxpayers regardless of the jurisdiction in which that income is derived. Taxpayer argues that this apportionment methodology results in resident and nonresident taxpayers being treated differently and that the methodology does not reflect the true nature of the taxpayer's in-state activities.

VI. Abatement of the Ten Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

The taxpayer requests that the Department exercise its statutory authority to abate the ten percent negligence penalty. Taxpayer argues that any failure on its part to adhere to Indiana statutes and the Department's regulations was based upon reasonable cause and was not due to negligence.

STATEMENT OF FACTS

Taxpayer is a bank holding company registered as such under the Bank Holding Company Act of 1956. Several of the taxpayer's subsidiaries conducted the business of financial institutions within the state of Indiana and were required to file a unitary Financial Institution Tax Return.

DISCUSSION

I. Whether I.R.C. § 265 Expenses Should Be Deducted From the Denominator of the Apportionment Factor.

Taxpayer protests the netting of I.R.C. § 265 expenses against municipal income added back for determining the amount of income included in the denominator of the apportionment factor. The Department apportioned the taxpayer's income in accordance with IC 6-5.5-2-4. IC 6-5.5-2-4(2)(B) defines the denominator as including "the receipts of all the members of the unitary group from transacting business in all taxing jurisdictions." There is no statutory provision for netting I.R.C. § 265 expenses.

FINDING

The taxpayer's protest is sustained.

II. Whether I.R.C. § 291 Expenses Should Be Deducted From the Denominator of the Apportionment Factor.

Taxpayer protests the netting of I.R.C. § 291 expenses against municipal income added back for determining the amount of income included in the numerator and denominator of the apportionment factor. The Department apportioned the taxpayer's income in accordance with IC 6-5.5-2-4. IC 6-5.5-2-4(2)(B) defines the denominator as including "the receipts of all the members of the unitary group from transacting business in all taxing jurisdictions." There is no statutory provision for netting I.R.C. § 291 expenses.

FINDING

The taxpayer's protest is sustained.

III. Whether Foreign Exchange Income Should Be Deducted From the Denominator of the Apportionment Factor for Purposes of Determining the Financial Institutions Tax.

The taxpayer protests the deduction of foreign exchange income from the denominator of the apportionment factor. For the exclusive and limited purpose of determining the taxpayer's Financial Institutions Tax, under IC 6-5.5-1-10 "'Gross income' means gross income (as defined in Section 61 of the Internal Revenue Code) for federal income tax purposes." The issue becomes not whether this type of income constitutes an "actual receipt" but whether the income is a "receipt" as defined within I.R.C. § 61. The term "receipts" is defined in I.R.C. § 61 with no adjustment downward for foreign exchange income. Accordingly, for the limited purpose of determining the taxpayer's Financial Institutions Tax, the taxpayer's foreign exchange income should have been included within the denominator of the apportionment factor.

FINDING

The taxpayer's protest is sustained.

IV. Whether Taxpayer, As a Bank Holding Company and Its Various Subsidiaries, Constitute a Unitary Group.

The taxpayer protests the determination that, for purposes of the Financial Institution Tax, the taxpayer, consisting of a bank holding company and its subsidiaries, should be treated as a unitary business. The taxpayer argues that it "has separate management, accounting, executive force . . . for every entity." Taxpayer Protest Letter, March 18, 1999, p. 4. The taxpayer adds, "any inter-company transactions are set up at arms length as mandated by the federal reserve." Id.

The definition of "unitary business" is set forth in IC 6-5.5-1-18 which states that "'Unitary business' means business activities or operations that are of mutual benefit, dependent upon, or contributory to one another, individually or as a group, in transacting the business of a financial institution." IC 6-5.5-1-18(a). In making that determination, the statute states that "[u]nity is presumed whenever there is a unity of ownership, operation, and use evidenced by centralized management or executive force, centralized purchasing, advertising, accounting, or other controlled interaction among entities that are members of the unitary group . . . ." IC 6-5.5-1-18(b). In attempting to overcome the statutory presumption, taxpayer has set forth a bare assertion that its subsidiaries operate under individual management, accounting systems, executive control, and that inter-company transactions are conducted at arms length. However, taxpayer has failed to set forth – to any quantifiable or substantive degree – the degree of independence which is afforded the individual subsidiaries or the amount of discretion under which those subsidiaries are permitted to operate. Quite simply, the taxpayer has failed to overcome the presumption, that it operates a "unitary business," mandated under IC 6-5.5-1-18(b). Consequently, having failed to overcome the statutory presumption, taxpayer comes within the purview of 45 IAC 17-3-5(d) which states that "if one (1) member of a unitary group is conducting the business of a financial institution in Indiana, then all members of the unitary group engaged in a unitary business must filed a combined return, even if some of the members are not transacting business in Indiana." Accordingly, taxpayer is required to file on a unitary basis under the state's Financial Institutions Tax.

FINDING

Taxpayer's protest is respectfully denied.

V. Constitutionality of the Application of the Apportionment Method for Unitary Groups Filing a Combined Return.

Taxpayer protests the method of apportionment as set out in IC 6-5.5-2-4. That code provision states that:

> For a taxpayer filing a combined return for the unitary group, the group's apportioned income for a taxable year consists of: (1) the aggregate adjusted gross income, from whatever source derived, of the resident taxpayer members of the unitary group and the nonresident members of the unitary group; multiplied by (2) the quotient of: (A) all the receipts of the resident taxpayer members of the unitary group from whatever source derived plus the receipts of the nonresident taxpayer members of the unitary group that are attributable to transacting business in Indiana; divided by (B) the receipts of all the members of the unitary group from transactions business in all taxing jurisdictions.

The taxpayer argues that apportionment methodology has the effect of "inflating the apportionment percentage, thus apportioning income to Indiana in excess of the State's fair and appropriate share," (Taxpayer Protest Letter, March 18, 1999, p. 4) and that the "Code discriminates against unitary groups filing combined returns." Id.

Presumably, the taxpayer challenges the Financial Institutions Tax on equal protection grounds. However, given the paucity of the taxpayer's argument, the presumption of constitutionality afforded state statutes, and the fact that an administrative hearing in the Indiana Department of Revenue is not the proper forum to challenge the constitutionality of the Financial Institutions Tax, the Department must decline the opportunity to address this issue.

FINDING

The taxpayer's protest is respectfully denied.

VI. Abatement of the Ten Percent Negligence Penalty.

Taxpayer protests the imposition of the ten percent negligence penalty and requests that the penalty, assessed pursuant to IC 6-8.1-10-2.1 be abated. Under 6-8.1-10-2.1(d), the Department is empowered to waive the ten percent negligence penalty if the taxpayer can establish that his failure to pay the deficiency was due to reasonable cause and not due to willful neglect. Under 45 IAC 15-11-2(c), in order to establish reasonable cause, the taxpayer must demonstrate that he exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. Ignorance of the listed tax laws, rules, and/or regulation is treated as negligence. 45 IAC 15-11-2(b).

Factors which may be considered in determining reasonable cause include the nature of the tax involved, judicial precedents set by Indiana courts, judicial precedents established in jurisdictions outside of Indiana, published Departmental instructions, information bulletins, letters of findings, rulings, and letters of advice. 45 IAC 15-11-2(c).

Taxpayer asked that the Department exercise its discretion to abate the ten percent negligence penalty. Taxpayer argues that it was undergoing its first audit under the Financial Institutions tax, was not attempting to evade taxes, and that there was limited

authority or guidance available to assist the taxpayer in preparing its Financial Institution Tax returns.

Taxpayer is a substantial and sophisticated business fully capable of determining its tax liabilities. Because taxpayer has failed to set out substantive, specific reasons for reaching the decisions that it did, the Department must decline the opportunity to abate the ten percent negligence penalty.

FINDING

The taxpayer's protest is respectfully denied.

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